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A Review of Strategic Issues and Implications of Mergers in the Indian Banking Sector

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Abstract – Banking is quickly becoming a global sector with no geographical or territorial borders. The rising number of mergers and acquisitions in the banking business are symptoms of an inorganic growth process. With the growth of global trade, there has been a continuous increase in cross-border mergers. This article makes an attempt to examine banking sector trends as well as the history of mergers and acquisitions in various nations. In this paper discuss the introduction of Indian Banking Sector, and importance of banking, mergers, economic and behavioral theory of merger, rationale for mergers in banking sector, facets of merger activity, reasons of mergers and amalgamations.

Key Words – Mergers, Indian Banking Sector, Merger Activity, Amalgamations, Scenario, Horizontal Merger, Vertical Merger

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1. INTRODUCTION

The banking industry has been converted from a highly regulated and protected system to a more competitive and deregulated segment across the globe. The world has become smaller as a result of globalization and technological advancements. Customers around the world have access to financial services and products. Institutional performance relied heavily on new ideas and innovations. As recently as the 1980s size, which had lost its luster, was once again a factor in banking. Changes in globalization and deregulation, hallmarks of the international banking and finance policy framework, are redrawing the contours of banking structures around the world. As a result of the Southeast Asian financial crisis and other economic instability in developing countries, it is clear that solid banking institutions are essential for sustainable economic progress. Consolidation is the only way to improve the competitiveness and quality of the banking sector, which is why it is being pursued in India, too. It doesn't matter if you're talking about Mergers and Acquisitions in the free market or worldwide market consolidation. As technology, competition, and new markets and products become more prevalent in today's operational environment, the current structure cannot keep up. Because of the need for increased capital, risk management, financing development projects, technological up gradation and improvement in customer service, and a global reach with a variety of financial product and services, such as agency functions, dealings in foreign exchange, insurance, mutual fund, venture capital and merchant banking, as well as factoring and leasing among many other things.

1.1 Scenario of Indian Banking System

India's banking system had previously seen a number of crises and failures prior to independence. As a result, it grew very slowly. The Indian banking industry, on the other hand, has seen remarkable growth since independence. The Reserve Bank of India's control and guidance of the Reserve Bank of India's planned economic growth, increase in money supply, and growth of banking habits were all factors in this. The function of public sector banks in economic development and resource mobilisation, particularly in rural and poorer areas of the economy, was originally played by the public sector banks. However, the lack of competition was caused by a system of regulated prices, tailored banking products, and only a few participants. Ownership by the state resulted in political intervention in its operations, which stifled new ideas. The combination of the foregoing reasons, as well as an insatiable need to develop, led to a major banking crisis.[1]

1.2 Current Status of Banking Industry in India

In the post-economic reform period, the banking sector in India has undergone a paradigm shift. In terms of financial strength, stability, and vitality, it has become a major player in the global economy. Other financial institutions have not challenged the banking sector's all-pervasive intermediation as the primary provider of financial services. Aside from insurance and investment banking, it has grown more tenacious and varied since making these diversifications. Competitive and tech-savvy banks have emerged in the last few years. They are profitable, reliable, and have remarkable performance metrics. Over 75,000 branches and 26 government-owned banks make up the Indian banking system, which lends and advances Rs. 4,47,277,40 million. There are a total of 8 lakh employees in the government sector, with a business per employee of 127.47 rupees and a net NPA ratio of 2.02. Commercial bank deposits totaled Rs. 5,74,56,972 crores. Nationalized banks in India serve a wide range of commercial and agricultural sectors. Rural and semi-urban areas are well served by banks, as well. The total amount of money invested was Rs 62,61,063 crore. As opposed to public sector banks in India, private sector banks have a lower NPA of 0.52.

1.3 Importance of Banking

In today's global economy, banking is an essential component for the growth of every country's economy. In actuality, any country's financial system is controlled by the country's banking system, which in turn ensures the nation's progress. It is widely agreed that a healthy financial system is essential for both the economy and society. Thus, it may be concluded that banks play an important role in the nation's socioeconomic well-being. In the next section, we'll go through some of the bank's advantages.

1. **Stimulate saving Behaviors:** The function of the bank in influencing people's saving habits is significant. Depositors are attracted to banks by many techniques, such as a higher interest rate on fixed deposits. As a result, consumers are more likely to deposit money in a bank since they know that their money is safe and will grow at a quicker rate than if they use any other method.

2. **Assistance to Businesses and Industry:** The banks are providing businesses with the capital they need to run and develop their activities. People are encouraged to deposit money in banks, which is then loaned out to enterprises as capital. Without the assistance of banks, no company or industry can even consider expanding.

3. **Support in Commercial transactions:** We all have to deal with money on a daily basis, either as individuals or as organisations. In particular, when we need to transmit money to remote locations, banks are the only option. A well-developed banking system offers a wide range of services, including online banking, mobile account management, and credit cards. Using these kinds of administrators improves the speed and efficiency of bank operations.

4. **Employment Generation:** As a result, the banking industry employs millions of people and contributes to the economy by providing services to its consumers.

5. **Assisting Farming and agricultural output:** India's economy is heavily reliant on the agriculture industry. Farmers typically require loans to produce agricultural goods in this industry, which is dependent on the monsoon rains. This is where the banks play a big role since they provide lower interest loans.

6. **Monitory Policy:** The country's financial policy is implemented mostly through banks. The primary goal of monetary policy is to reduce inflation, which may be readily accomplished through banking system rules.

2. REVIEW OF LITERATURE

Shyamji Agarwal (2000) the patterns of bank consolidation and their significance in India were discussed. An examination of financial institutions in India was used in the report, and it gave significant information for restructuring purposes. It also discusses a wide range of views and analytical inputs to aid in the formation of bank restructuring policies.[2]

Vives, (2000) banks' capital structure, evaluated as the CA/TA ratio, was investigated as part of the study. This method has been elevated in relevance by practitioners, analysts, and regulators. Since competitiveness in banking is a major goal of prudential regulation, capital requirements and proper supervision have become a major focus of bank regulation, a prudential regulatory approach. According to the current theory of the banking company, banks' uniqueness in an information-asymmetrical environment is a key factor in their ability to outperform their peers. Good banks can communicate their quality by increasing their capital more cheaply than poor ones since bank managers often have an equity part in the firm's capital.[3]

Beena (2008) To see if mergers and acquisitions are actually affecting the industry's concentration level, researchers conducted a study. The author employed an unique database of mergers and acquisitions in the pharmaceutical business and applied different least squares regression frameworks to evaluate the impact of these transactions. Results showed that mergers and acquisitions had a significant impact on the market structure of the sample industry studies and emphasised the need of integrating pharmaceutical policy and competition policy.[4]

Siddhartha S Brahma and Kailash B L Srivastava (2007) Integration was evaluated as a possible moderator in the research. Acquisitions with a high risk of executive departure should be avoided unless the acquirer has taken the required steps to retain the target workforce. Whether the acquirer intends to completely integrate the acquired business or not, communication is critical. Performance will improve if the new hires are properly communicated with. Managers, therefore, should be sure to prepare thoroughly before integrating these factors.[5]

Siddhartha. S. Brahma (Nov 2003) It has been pointed out that M & A are becoming increasingly popular and effective means to build a company. The author points out that a significant proportion of mergers and acquisitions have not taken into account organisational and human resource difficulties. For future studies on human viewpoints, this article identifies crucial concerns and questions.[6]

Siva Kumar. K and Rao. U. S. (2003) Comment on today's flurry of mergers and acquisitions, which is affecting every sector of business and completely altering the market. An analysis of the current trend of mergers compared to those in the past is presented in this paper. There are some fascinating similarities between this and the beginning of the century, which suggests that merger waves are cyclical and that they are reappearing near the end of the century.[7]

Kumudini S. Hajra (2002) Companies' responses to rising convergence in the operations of diverse financial corporations, such as banks, investment companies, insurance companies, and other sorts of financial organisations. Research shows that ICICI bank would benefit from a merger in terms of ICICI's bigger capital base, greater operational scale, and access to ICICI's strong corporate clients.[8]

Surjit Kaur (2002) used eight financial ratios to analyse the pre- and post-takeover performance of a sample of 20 merging enterprises over a period of three years each, immediately preceding and following the merger. EBITDA/Sales (EBITDA/Sales), ROCE (Return on Investment), and Asset Turnover Ratio all decreased significantly in the post-takeover era, demonstrating that profitability and efficiency of merging enterprises both decreased in the post-takeover period. It was not statistically significant, however, when the 't' test was performed.[9]

Swaminathan (2002) It was observed that four out of five of the purchasing corporations increased operating and financial synergies three years following the merger in a sample of five examples analysed between 1995 and 1996. Net Profit Margin significantly increased after the merger, but asset turnover did not exhibit any meaningful change-the study found that shareholder value enhanced for smaller mergers, but not for larger mergers.[10]

3. MERGERS

When two or more businesses come together to form a single business, it is a merger. An current business entity or a new one can be formed through the merger of the one or more business firms. When two or more companies combine, their assets and liabilities as well as their owners' interests and businesses are entwined. In other words, in a merger arrangement, the good-performing business will acquire all of the bad-performing firm's assets and liabilities. Statement of Accounting Standards (AS-14) - Accounting for Amalgamations- Laws in India utilise the terms "mergers" and "amalgamation" interchangeably, according to the Institute of Chartered Accountant of India (ICAI).[11]

3.1 Types of Merger

The phrase merger and acquisition is used to cover a wide range of combination activities, from the merging of 100 or more companies to the purchase of one company by another in the same core industry or in wholly unrelated fields of operation. There are two general classifications for mergers: one relates to the form of the merger (i.e., whether it is a consolidation of firm or an acquisition of one firm by another), and the other relates to the type of merger, which depends on the industrial or commercial relationship of the firm involved in the merger.. An combination of two or more businesses into a single company is called a merger or consolidation. It is possible to think of mergers and acquisitions as the one-at-a-time variant of the merger; with mergers, a larger or stronger company takes over a smaller one. Companies that combine keep their own identities and complete the purchase by extending their own capital or by using cash reserves, if any are available.[12]

There are several ways to enhance the benefits of mergers In order to be classified as a merger, the relationship between the companies involved must be defined. A horizontal merger occurs when two or more companies in the same industry unite to form a single conglomerate. An example of this would be the merger of two cement companies. Horizontal mergers can also result in geographical diversity, which occurs when companies that make the same items are situated in various market areas and offer those products. A vertical merger can be either pursued (such as an automotive manufacturer purchasing a tyre maker) or it can be used to offer facilities to process or distribute commodities at different stages in the distribution process. (such a shoe manufacturer buying a chain of retail shoe stores). Products or services that are distinct from one other but are distributed via the same channels are part of a "expansion" merger, which is a sort of circular merger. This is similar to a laptop manufacturer acquiring a CD-manufacturing company, with both products being sold in the same retail locations. In the context of a conglomerate merger, two or more companies that have no obvious connection to each other's production or marketing operations are combined (such as mining company buying an ice cream producer).

3.2 Economic and Behavioral Theory of Merger

This form of economic activity can occur at any moment since a merger can be considered as an exchange and combining of property (unless there is specific laws design to prevent it). When the economic, legal, and political conditions are right for mergers, massive waves of merger activity (a time period defined by significant increases in activity across a wide range of business and industrial sectors) emerge. A good economic climate is one that is marked by a strong stock market and an extended period of relative prosperity. A favourable legal climate is created by ambiguous legislation and a shaky interpretation and tax enforcement policies. The administration (the executive branch) and the legislative branch (the legislative branch) must be characterised by a tolerant attitude and a lack of care (particularly in the absence of an economic crisis, coupled with pressures from powerful lobbies). During periods of increased merger activity, it is unlikely that concentration would decrease overall, and many of the mergers will be less than spectacularly successful. It is easier for merger proponents to fulfil their primary aims of personal wealth when the climate is favourable since mergers are fairly simple to execute during these generally successful eras; the fear images harm. Legal action is decreased; it is difficult to ascertain consolidated results; and there is a general absence of public company.[13]

3.3 Mergers May Be Horizontal, Vertical or Conglomerate

- A horizontal merger is a combination of two or more firms in a similar type of production, distribution or area of business.
- A vertical merger is a combination of two or more firms involved in different stages of production or distribution.
- A conglomerate merger is a combination of firms engaged in unrelated lines of business activity. Furthermore, these may be friendly or hostile.

3.3.1 Horizontal Merger

The term "horizontal merger" refers to the joining of two or more companies that are in the same industry, i.e. manufacturing or providing the same products or services. An example of this is Associated Cement. The following are examples of horizontal mergers:

a) **Complementary Merger:** This structure allows for the union of businesses with well-established reputations for specialisation in a variety of industries. Take the merging of XYZ, a treasury operation powerhouse, with ABC Bank's money market operations expertise.

b) **Competitive Merger:** This is a merger between two businesses that specialise in the same area. Such an alliance may potentially result in an apple monopoly in that industry. For example, if two of the world's leading manufacturers in the Forex sector merge into a single company, they will remove all competitors and get an absolute grip on the market.

c) **Geographical Merger:** There are two firms involved in this merger, both of which have a presence in the same region. For example, to enhance their market share, the manufacturing sector XYZ in the north combines with the manufacturing sector ABC in the south.

3.3.2 Vertical Merger

A vertical merger is a merging of two or more companies involved in separate phases of production in an industry (i.e., manufacturing different goods but with a customer supplier relationship wherein the product of one business is utilised as raw material by the product of the other).

3.3.3 Conglomerate Merger

In the case of a conglomerate merger, two or more companies that are engaged in unrelated lines of business (i.e., a completely different industry) unite to form a single entity. Shareholders, creditors, workers, the government through monopolistic commissioners, lending financial institutions, stock exchanges, high courts, and others all have a stake in any merger of publicly traded corporations.

3.5 Rationale for Mergers in Banking Sector

In order to gain the following advantages, the combined value of the merging entities must be larger than the independent values of the merging entities.

- **Cost benefits -** economies of scale, organizational efficiency, Funding, costs and risks diversification,
- **Revenue benefits -** economies of scale, enhancing monopoly rents,
- **Economic conditions -** mergers after business crises or after the upswing of the Business cycle to initiate strategies.
- **Other consideration -** private managerial benefits, defense against Takeover, etc.

3.6 Facets of Merger Activity

3.6.1 Homogeneous Facet

1. Merger Data

2. The Magnitude of the Movement
3. Merger and Concentration
4. The Promoters of Mergers
5. Professional Interest
6. Public Concern

3.6.2 Heterogeneous Facets

1. Change in Merger Form
2. Change in Merger Type
3. Change Related to market Control
4. Merger and Growth of Firms
5. Mergers and the Economy
6. The Environment for Mergers
7. Mergers and the Economist

3.7 Reasons of Mergers and Amalgamations

A list of nine primary causes for mergers and acquisitions has been compiled by David J. Ravenscraft and F.M. Scherer of Economics at Swarthmore College.

- **Management Displacement:** removal of inefficient, entrenched Management.
- **Synergies:** Efficiencies gained when two Banks/ compames merge, then the total benefit exceeds the sum of two merged instructions.
- **Monopoly:** Profit potentials are increased through greater market power.
- **Tax Motivation:** This is also the main reason for any M&A.
- Bargain Motivations for Specific Assets.
- **Risk Diversion:** Efforts by conglomerates to damper the cyclical swings of portions of their holdings.
- **Hubris:** Over estimates by an acquiring firm's Management of the synergies or efficiencies possible.
- **Empire Building:** Managers seeking to enhance their own prestige and power.
- **Speculative Motivation:** This factor also affects the M&As activities to a great extent.

3.8 Motives for Merger

As a result of the synergy between the various factors that influence an acquisition, 2+2=5. This signifies that the merged company's performance is greater than the total of the performance of the two formerly independent enterprises that were previously part of it. Let's take a closer look at the reasons behind the merger. In the United States, a research found that there are 12 reasons why mergers and acquisitions are encouraged.[14] Below, they are arranged in the order in which they are most important:

- Taking advantage of awareness that a company is undervalued.
- Achieving growth more rapidly than by internal effort.
- Satisfying market demand for additional products/services.
- A voiding risks of internal start-ups of expansion.
- Increasing earnings per share.
- Reducing dependence on a single product/service.
- Acquiring market share or position.
- Offsetting seasonal or cyclical fluctuations m the present business.
- Enhancing the power and prestige of the Owner, CEO, or Management.
- Increasing utilization of present resources, Et., physical plant and individual skills.
- Acquiring Outstanding Management or Technical Personnel.
- Opening new markets for present product/services.

3.9 Effects of Merger

- **Achieving economies of scale:** A merger can frequently lead to economies of scale since, until an ideal level, output after the merger will grow while inputs stay static. This is because some bank inputs are fixed.
- **Stabilization of asset quality for smaller banks:** Smaller banks will benefit greatly from a merger and the resulting rise in size, which will result in a significant boost in the quality of their assets.
- **Acquiring size through the less cumbersome inorganic route to meet**

competition: The best course of action is to have a plan in place before making this decision, as it may be based on a spur of the moment thought.

- **Bringing Complementary strengths to the table:** Synergy, where 2 + 2 equals 5, might be another version of this. This will occur if the corporate partnership shows to be more profitable than the combined powers of the two merging businesses.

- **Managerial efficiency:** A hostile takeover or bailout merger may not necessarily be the cause of this. There is a legitimate belief that the acquiring bank's management will be superior at running the acquired bank, even in the event of a well-run bank. Typically, these mergers provide value to the company's stockholders.

- **Augmentation of capital base, mainly regulatory capital:** This will be a crucial element in bank consolidation because of the strictness of basel II regulatory capital standard compliance.

- **Geographical diversification:** In this way, a bank may mitigate the risks associated with concentrated lending in a single or contiguous area by diversifying its portfolio.

- **Wider array of low priced products for customers:** Better prices and new items are the byproducts of economies of scale.

- **Cross selling of each other's products and services:** Customers with high net worth, both individuals and businesses, prefer to do business with banks that provide a wide range of goods and services since doing so means disclosing their private information to only one institution. This benefit has received little attention, despite its importance.

- **Tax Shields:** An acquirer's responsibility might be eliminated in a rescue merger if the insolvent bank has accrued losses and unclaimed depreciation benefits, which would result in tax advantages for the acquirer.

- **Less cumbersome bank supervision:** When there are a few major banks, the RBI will find both offshore and onsite monitoring to be less burdensome. Guidelines may be put into action in a more efficient manner.

- **Capital augmentation:** As a result, fewer net NPAs might be achieved by increasing provisioning for gross NP As.

- **Asset Reconstruction:** It will be possible for merging bank groups to form up their own Asset Reconstruction Companies to which they can transfer NP AS.

4. CONCLUSION

This Paper reveals that private sector banks benefit from mergers, whereas public sector banks benefit from mergers, however the results are a little inconsistent. In the post-merger period, certain indicators suggest a positive improvement, while others show a decrease. The history of banking and mergers in particular reveals that mergers have a favourable influence on the banking industry. In both the Indian and international banking industries, mergers have been a boon to growth. As a result, mergers also assist to reduce competition, achieve the goal of development and expansion, and give numerous tax advantages. In the end, we may conclude that merger and acquisitions can be a positive source of development and expansion if the deal is undertaken with thorough investigation and consideration of the firm's long-term objectives.

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